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Lessons for developing and Eastern European countries

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NEW EXPLANATIONS OF THE ECONOMIC SUCCESS OF EAST ASIA:

Lessons for developing and Eastern European countries

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Abstract

The economic success of the East Asian countries has inspired many economists to study the background of their rapid growth. Interestingly, different economists interpret this success in entirely different ways. During the 1970s and an important part of the 1980s advocates of the neoclassical model argued that growth in East Asia was the result mainly of the market mechanism and the emphasis on export promotion in these countries. Especially since the mid-1980s the neoclassical approach was criticised by economists who stressed that government intervention played a crucial role in the process of economic growth. This paper aims at presenting a survey of the arguments recently put forward by the critics of the neoclassical approach to explain the role of government in the economic success of the countries in East Asia. Such a survey is very useful, since it forms a new breeding ground for the discussion on the role of the government in the economic deve-lopment of other developing countries and the countries in Eastern Europe.

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1. Introduction

Without a doubt East Asia's economic expansion during the past twenty years is one of the most remarkable economic changes since the Second World War. Gross national product of the East Asian countries[2] increased by more than five per cent per year in the period 1965-1990, which is considerably larger than that of Latin America (1.8 per cent), sub-Saharan Africa (0.3 per cent), or even the OECD (2.4 per cent). Six of the seven fastest growing economies in the period 1960-1985 (measured on the basis of the average growth of per capita GDP) were East Asian countries.[3]

The economic success of these countries has inspired many economists to study the background of this rapid growth. What is rather remarkable in this context is the fact that different economists interpret this success in entirely different ways. During the 1970s and an important part of the 1980s advocates of the neoclassical model argued that growth in East Asia was the result mainly of the market mechanism and the emphasis on export promotion in these countries. This interpretation dominated the debate for a long time. Especially since the mid-1980s the neoclassical approach was criticised by economists who stressed that government intervention actually played a crucial role in the process of economic growth. In this paper these economists are referred to as the *new interventionists*.[4] The debate between the neoclassical economists and the new interventionists seems to concentrate on the issue concerning the role of the government in the process of economic development in general, and the East Asian growth miracle in particular.

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[2] In this article East Asia includes the following countries: Japan, South Korea, Taiwan, Singapore, Hong Kong, Indonesia, Thailand, and Malaysia. A significant part of the literature used for this article concentrates mainly on South Korea and Taiwan.

[3] Data from the World Bank (1993, pp. 2-3).

[4] Elsewhere in the literature they are also referred to as *revisionist*, *structural* or *heterodox* economists.

This paper mainly aims at presenting a survey of the arguments recently put forward by the critics of the neoclassical approach to explain the economic success of the countries in East Asia. In particular, it emphasises their view with respect to the role of the government in the process of economic development. Such a listing of the contributions of the new interventionists concerning the backgrounds of the Asian miracle and the possible contribution of the government is very useful. It forms a new breeding ground for the discussion on the role of the government in the economic development of other developing countries and the former socialist countries in Eastern Europe.

The article is structured as follows. Section 2 presents a survey of the contributions of development economists with respect to the role of the government in the process of economic development as put forward by them in the 1940s and 1950s. Section 3 describes the reactions of the neoclassical economists on these early contributions. They emphasised that especially the market mechanism played an important role in the growth of the East Asian countries. Section 4 deals with the critics of the neoclassical economists and describes their approach to the backgrounds of the Asian miracle. Section 5 contains a synthesis of both approaches with respect to the role of the government versus the market in the growth of East Asia. Section 6 discusses the possible lessons for other developing countries and the countries in Eastern Europe concerning the role of the market versus the government in the process of their economic growth.

2. The Early Discussion on Economic Development and the Role of the Government[5]

[5] See also Krugman (1993).

The discussion on the role of the government in the process of economic development originated in the 1940s and 1950s. This discussion fits into the postwar predominance of Keynesian economics. During this period several theoretical models contributions in the literature pointed out that market imperfections justified government intervention. The main emphasis was on the existence and benefits of economies of scale and the external effects of production. One of the most influential models was the model of industrialisation based on the notion of *infant industry*. The existence of dynamic economies of scale and positive external effects of production in certain industries prompted the government to actively stimulate the development of these industries since the private sector was thought to be incapable of assessing the long-term economic benefits of investing in these industries. According to this model the government would stimulate the development of these industries by means of subsidies and protective measures until they were sufficiently developed to produce without government support.

Other models went further in their recommendations concerning the role of the government in development. According to several economists, the economic growth potential of developing countries was restricted since many of these countries mainly exported primary goods. They expected that the prices of these goods relative to prices of industrial goods would fall permanently; this is also known as *export pessimism* (Prebisch, 1950). By combining the infant industry argument with export pessimism they pointed out that a structural change in the production structure of these countries was absolutely necessary in order to obtain positive long-run economic growth prospects. The government ought to play an important role since such a drastic change could never be realised through the market mechanism due to considerably large coordination problems in the economy. The emphasis was put on improving infrastructure and education. Both these aspects were assumed to be extremely important in order to realise such a structural change. Furthermore, the mutual dependence of industries was pointed out: the development of one industry was also determined by the development of other sectors, either as a producer of inputs or as a demander of output. This caused simultaneous support of different industries necessary.

Later on, the debate in literature concentrated on the way in which the government ought to intervene. Some supported simultaneous intervention in all industries essential to economic growth (*balanced growth strategy*; see Lewis, 1955; Nurkse, 1953; and Rosenstein-Rodan, 1943). Others stressed the limited availability of scarce resources which would hinder the execution of such a comprehensive strategy. They advocated government intervention mainly in those industries that had the most relations with other industries (*unbalanced growth strategy*; see Hirschman, 1958).

These models very much influenced the economic policies pursued by the various developing countries during the 1950s, 1960s, and a large part of the 1970s. The idea of a government intervening in the process of economic growth was appealing to many politicians. It contributed to developing models of central planning, and it stimulated to using trade policies, such as import quota, export subsidies, and fixed exchange rates, introducing price controls and subsidies in markets for goods and production factors, and establishing public enterprises in important sectors like mining and heavy industries. Many governments pursued policies of import substitution (and later also export promotion). Initially, several countries appeared to be successful in achieving economic growth by way of government intervention. However, as increasingly more problems arose with respect to the models of planned economic growth, this approach was increasingly criticised by economists whose ideas matched the neoclassical tradition.

3. The Neoliberal Model and the Explanation of the Asian Economic Miracle

The criticism of the neoclassical economists - or *neoliberals*[6] - was aimed

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[6] This is the term to which they are referred to in the debate on the role of markets versus the government in the process of growth.

mainly at the fact that the above described models primarily pointed at the imperfections of the market mechanism; the models seemed not to be concerned about the possibility that government intervention in itself could also lead to an inefficient allocation of resources. The neoclassical economists rejected the implicit assumption that allocative inefficiency due to market imperfections would always be larger than the inefficiency resulting from government failures. This assumption would imply that the government has sufficient information in order to determine for which particular industries positive externalities and dynamic economies of scale could be expected, and to properly assess the costs and benefits of supporting certain activities and industries. This also would imply a well-functioning apparatus of government within which this information would be translated into a policy in the right way. Moreover, it meant that the government would also be strong enough to resist pressure groups and to minimalise the negative effects of rent-seeking behaviour. Finally, it was anticipated that the government put maximum welfare for the country as a whole before maximising the individual objectives of those representing the government.

The neoliberals very much doubted the fact that these conditions had been sufficiently met in developing countries. They were rather convinced of the fact that especially such factors as lobbying, rent seeking, and a government pursuing maximisation of the individual welfare function, would negatively affect the efficiency of intervention. Therefore, they concluded that the imperfections of government intervention generally exceeded market imperfections. Only in some cases the government could play a role, *e.g.* with respect to providing physical infrastructure, macroeconomic stability, and maintaining order and upholding the law. This is all the government should do. The device of *getting the prices right* plays a crucial role in the neoliberal view: if the markets are not interfered with, scarce resources will be allocated most efficiently. This criticism is best put into words by Krueger (1990[a] and 1990[b]) and Lal (1983), two of the most important representatives of the neoliberal view. Their starting points were the basis of the IMF and World Bank policy recommendations that were part of the structural adjustment programmes presented to developing countries in the 1980s and 1990s.

The neoliberal interpretation of the role of the government versus the role of the market in the process of economic development has also been applied in analysing the economic success of East Asia of the past three decades. According to the neoliberals, the governments of these countries observed the limits of their capabilities, and the economic success, therefore, was caused mainly by the market which functioned quite well. They especially pointed out the emphasis governments placed on developing and stimulating exports, private entrepreneurship, and the execution of market-oriented policy measures. Focusing on export enhanced the development of industries with a comparative advantage. The East Asian countries especially developed those industries in which they had a comparative advantage. The governments had created the right environment - by providing macroeconomic stability and public investment in social and physical infrastructure - in which the private sector was encouraged to invest in such a way that it would contribute positively to economic development.

The neoliberal interpretation of the economic success of the East Asian countries was supported by the observation that several African and Latin American countries, where the government had played a very significant role for several decades, had experienced a deep economic crisis since the 1980s. The failure of government intervention and the positive contributions of the market mechanism were elaborately discussed in studies by, among others, Balassa (1977), Corbo *et al.* (1985), Hughes *et al.* (1988), Krueger (1978), Little, Scitovsky, and Scott (1970), and Michaely *et al.* (1987). These studies considered the East Asian countries as examples of countries where the market mechanism had positively influenced the process of economic development.

The neoliberal criticism of the models from the 1940s and 1950s was justified to a certain extent. They rightly emphasised that too much government interference in the process of economic development could lead to considerable inefficiencies. They provided a theoretical basis for the possibility and consequences of government failure (Islam, 1992). Since the early 1970s and especially during the 1980s practically everybody agreed on the fact that government-led economic development, with an important role for state enterprises, would lead to large inefficiencies.

However, this did not automatically mean that the neoliberal alternative provided a correct interpretation of the backgrounds of the successes in East Asia (Wade, 1991). Since the mid-1980s there was increasing criticism of the neoliberal interpretation of the role of the market versus the role of the government in development. These critics can be referred to as *new interventionists*. This group of economists argued that the government could contribute more to economic development than just providing certain important public goods. They based their ideas mainly on their analysis of the backgrounds of economic success in East Asia. The centre of their analysis proved to have rather a lot in common with the analyses of and themes addressed by development economists of the 1940s and 1950s.

4. Criticism of the Neoliberal Model and the Arguments in Favour of Government Intervention

According to the new interventionists, the neoliberal interpretation could not explain satisfactorily the success of the East Asian countries. A growing amount of research showed that government could indeed contribute positively to growth by means of comprehensive intervention in the economic process. This was not in keeping with the usual neoliberal starting points, and therefore alternative approaches were sought after to explain for this finding.

An important alternative explanation of the East Asian economic success was found by emphasising the extent of problems concerning coordination in less developed economies. Critics of the neoliberal interpretation pointed out that the government could play an important role in stimulating the process of economic development by reducing coordination problems, related to the choice of and relationship between production decisions, that hinder development (see *e.g.* Akyüz and Gore, 1994; Amsden and Singh, 1994; Rodrik, 1994; and Singh, 1995). These problems concerning coordination are the result of dynamic economies of scale of production and external effects resulting from the strong mutual dependence of certain industries. If such circumstances do play a role, the allocation of resources on the basis of the market mechanism can quite easily become sub-optimal.

To begin with, in practice market prices provide information about the current profitability of productive activities; they contain hardly any - if at all - information on future profitability. Under these circumstances, if there are any activities that lead to economies of scale in the future, current market prices give the wrong signals with respect to optimal allocation. In this case, allocation will not be *dynamically efficient*. Moreover, investment decisions at the level of the individual entrepreneur may be sub-optimal if the future profitability of an investment project also depends on the degree to which investments are made in other sectors at the same time. In this case, too, allocation of resources based on the free market principle results in dynamically inefficient allocation.

According to the new interventionists, interventions of East Asian governments were mainly aimed at decreasing these coordination problems, thus stimulating economic growth. The interventions actually improved the economy since barriers caused by economies of scale and external effects were taken down, which probably would not have happened if resource allocation was based purely on market principles.

The model explaining the East Asian economic miracle as proposed by these new interventionists matches some of the central thoughts of the development economists of the 1940s and 1950s. One major difference, however, is that this model is formalised in some recent contributions (see, for example, Matsuyama, 1991; Murphy, Schleifer, and Vishny, 1989; and Rodrik, 1996).[7]

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[7] Recent theories on industrial organisation also point at the positive effect of limited competition - rather than free markets - and protection and co-ordination by the government (see,

The remainder of this section will discuss in more detail several of the above mentioned aspects of the East Asian intervention policy, such as the characteristics of industrial policies, the instruments that were used to stimulate specific investments, the institutional context, and the preconditions.

4.1 Industrial policy

The contents and effectiveness of the industrial policies pursued in the East Asian countries is the central focus of several new interventionist studies, focusing mainly on the analysis of the Korean experiences (see, for example, Amsden, 1989 and 1992; Auty, 1991; Hikino and Amsden, 1994; Wade, 1990; and Woo, 1991). Amsden (1989) is a seminal work in this respect, in which she presents a new interventionist interpretation of the economic development of South Korea. In her analysis she shows why the Korean government policy can be considered dynamically efficient. She emphasises the fact that government intervention led to a situation of *getting the prices wrong*, which, according to her, precisely resulted in an optimal allocation of scarce resources. By deliberately disturbing prices, the government was able to reduce the coordination problems that occur when allocation of resources is left to the market mechanism. Policies aiming at disturbing the market mechanism led to other priorities concerning what should be produced as compared to the outcomes of the market as the coordinating mechanism. The industrial policies of other rapid growers in the region has been interpreted in a similar manner in other studies (see also Wade, 1990; and Rodan, 1989).

Amsden characterises the process of economic development in South Korea as the process of *late industrialisation*. Fast growth in this country is mainly based on the implementation of existing (Western) technologies. The aspect of learning, adopting and adjusting existing technologies is central in her analysis. Since learning processes have the characteristics of a public good and are

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for example, Jacquemin, 1987; and Schmalensee and Willig, 1989).

closely related to increasing economies of scale and the external effects of production, government intervention is vital in the process of late industrialisation. The government sees to it that the Western technology is copied and implemented as efficiently as possible, and that the labour force is educated sufficiently to work with the new technology (Hikino and Amsden, 1994). Moreover, they coordinate production decisions in different industries. Thus, the government becomes an entrepreneur who decides what, when, and how much to produce (Amsden, 1989).

The active intervention resulted in the industrial development of South Korea, which would not have been realised without government intervention, according to Amsden. The government especially stimulated those industries that were thought to be of crucial importance to the long-term development of South Korea. Whereas in the 1960s mainly export-oriented industries were stimulated, in the 1970s emphasis was placed on the development of heavy and chemical industries, the electronics industry, and shipbuilding. In the 1980s the centre of attention of industrial policies shifted towards stimulating the development of high-quality industries, the so-called sunrise industries. Due to government intervention South Korea became a leading producer of micro-chips, and had an important share in the world markets for consumer electronics, cars, and in shipbuilding. In this context, Amsden and others (Amsden and Singh, 1994; Auty, 1991; Singh, 1994; and Wade, 1991) point out the difficulties involved in the development of especially heavy and chemical industries, and in electronics and shipbuilding. The relatively long time these industries require to reach maturity, and the limited profitability (or even temporary loss) during the initial phase cause these industries to be rather unattractive when it comes to private investment. This provides a legitimate reason for an active industrial policy by the government.

4.2 Instruments of government intervention

The East Asian governments used various instruments that enabled them to influence the organisation of production decisions and the allocation of production factors, in order to achieve that scarce resources would be applied in the areas they preferred. These instruments primarily aim at creating *rents*, *i.e.* providing subsidies for certain investments. A subsidy may be a strong instrument to influence the use and allocation of means, provided that the granting meets certain conditions (see below). A subsidy will contain a protective element on the one hand, and provide an incentive to implement specific activities on the other hand. Given these conditions, a subsidy may contribute to the fact that investors who are granted a subsidy may take into account more than short-term profitability only, and may also consider future possible profitability of the decisions. In these cases, the dynamic aspects of implementing investment decisions are taken into account, and thus granting subsidies may contribute to a better allocation of means.

Initially, subsidies were granted by means of programmes for cheap credit and selective credit loans. In countries like South Korea and Taiwan, the government had a significant impact on determining the nominal deposit and loan rate in the 1960s and 1970s. Moreover, they also introduced guidelines with respect to the allocation of bank loans to the private sector. Thus, they were able to stimulate the development of specific industries and private activities by granting them access to external funding and by subsidising this funding.[8] Furthermore, instruments like tax advantages, selective granting of available foreign currencies, and the stimulation of cartels were used to positively influence the investment behaviour of the private sector. Finally, in certain specific cases, like for example the case of the South Korean shipbuilding industry, the government explicitly guaranteed that possible loss-making investment decisions would be compensated for. Rodrik (1994, pp. 32-33) refers to this as "...the socialization of investment risk in selected sectors."

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[8] Several papers have been written on the role of interventions in financial markets. See, among others, Cho (1989), Cho and Hellmann (1993), Choi (1993), Hellmann, Murdock, and Stiglitz (1995 and 1996), Hermes (1995, chapter 5), Vittas and Cho (1995), Vittas and Wang (1991), and World Bank (1993).

The new interventionists explain the fact that rents did not lead to economic inefficiency - as the neoliberals generally argue - by means of a number of specific characteristics of the way East Asian governments created and used rents (Akyüz and Gore, 1994). First, they were introduced only for those activities that were important to the nation as a whole. Second, they were not simply granted directly to individual firms. Firms had to compete for these subsidies (so-called contests; see, *e.g.* Amsden, 1989; Hellmann, Murdock, and Stiglitz, 1995; and World Bank, 1993). As part of these contests, they had to show why they should be granted a subsidy. The granting of subsidies was therefore linked to certain performance criteria the investment project would have to meet during its duration. Generally, this meant that firms would have to be able to prove the positive development of their productivity and profitability over a period time. With respect to the export industries, performance was measured on the basis of the development of their sales in foreign markets. Third, the rents were used only temporarily and selectively. Fourth, governments acted explicitly against speculative activities and the diversion of public funds to private use. Finally, the costs of rent seeking were small especially due to the strong ties between government and the private sector (see below, section 4.4).

In conclusion, it can be argued that the new interventionists particularly point at the fact that the government made use of the market mechanism when granting subsidies. Moreover, they stress the fact that the government could discipline companies with respect to the use of the means they were granted. Both these characteristics of granting subsidies form an important explanation of their positive effects on the efficient allocation of resources, according to the new interventionists.

Apart from granting subsidies in order to stimulate certain types of investment, in several cases governments were actively involved in taking specific investment decisions aiming at improving the coordination and cooperation between different projects. Rodrik (1994) and Wade (1990) present several examples that show that the governments of South Korea and Taiwan took the decisions in order to develop certain new industrial activities and subsequently supervised and participated in the implementation of these activities.

Finally, some authors point out that governments also made important investments themselves, for example in the physical infrastructure and in several basic industries (Jones and Sakong, 1980; Rodrik, 1994; and Wade, 1990). With repect to South Korea, they describe the characteristics of public enterprises as firms that have many linkages with other industries, are highly capital intensive, produce on a large scale, and produce mainly nontradeable goods and import-substituting products. It is precisely these types of industries and industrial activities for which coordination problems may be the most pressing.

4.3 The role of the export promotion policy

Especially with respect to the role of export-oriented policies as part of industrial policies, and the related specific instruments of government intervention in East Asia, the neoliberals and the new interventionists do not agree. In the neoliberal model the emphasis of government policies on export promotion is very important, since they believe that competition on world markets stimulated East Asian companies to produce efficiently. They exported especially those products for which the countries had a comparative advantage in production. According to the neoliberals, the rapid growth of exports justified this approach. Subsequently, the development of export industries was thought to have a positive effect on the production in other sectors of the economy (so-called spill-over effects). In this model - the so-called model of export-led development - the rapid growth of the export industries led to a growth in investment and was therefore the driving force behind the overall economic success (see, for example, Krueger, 1985; and World Bank, 1993).

The new interventionists disputed the neoliberal point of view. Some of them point out the fact that the governments created comparative advantages, thus actually reversing the causal relationship between export growth and comparative advantage. The above mentioned industrial policies in South Korea can again be used to illustrate this view. The South Koreans developed advantages in shipbuilding, and in the electronics and car industries, all industries in which they initially did not have comparative advantages. Some new interventionists stressed the fact that government intervention stimulated especially those export industries for which competition in international markets was fierce, in order to stimulate the building up of a competitive external sector. To a certain degree, this view resembles the neoliberal interpretation of the role of international trade, although the new interventionists put much more weight into the role of government intervention to a develop such a competitive external sector. They argue that international competition can be regarded as an *efficiency check* of interventionist policies and the policy measures used. The success or failure of export producing firms provided the government with information which enabled it to decide whether or not to continue support to particular industries, and to decide on the extent of this support. Thus, protection measures and the granting of subsidies were linked to the performance of firms with regard to the development of sales in foreign markets.

Others, however, resist the argument that exports played a crucial role in stimulating the economic growth of these countries (Rodrik, 1994). On the one hand, they point at the limited share of the export sector in total GNP of most East Asian growing countries in the period concerned. Considered this limited share, this sector could never have been the driving force behind the strong economic development during the 1960s and 1970s. On the other hand, the direction of the causality between exports and investments as supposed by the neoliberals is questioned. It is more likely that the explosive export growth was the result of a strong increase in domestic investments, rather than the other way round. The increase in these investments led to an increasing demand for imports, which - taking into account the limited availability of foreign currencies - went hand in hand with an increase in exports. This increase in exports was realised by reducing the domestic consumption of tradeable goods, making them available for exports. Exports were not hampered by any unfavourable exchange rate policies, which had indeed been the case in many other developing countries in the 1960s, 1970s, and part of the 1980s. They argue that export production was actively stimulated by means of several instruments, particularly the above described systems of subsidisation. Therefore, some new interventionists argue that the explanation of economic growth in East Asian countries lies in the factors that influenced the strong growth in domestic investments, such as the creation of rents to stimulate investment behaviour (Rodrik, 1994).

4.4 Cooperation between the state and the private sector

In the previous sections it has been pointed out continuously that the East Asian governments proved to be able to reduce coordination problems, which contributed to stimulate economic growth. However, this still has not answered the question concerning the way governments were able to dispose of sufficient information to efficiently coordinate investment decisions and to determine which industries were important in realising a dynamically efficient allocation of scarce resources.

Several studies have examined this aspect. These studies show that very close ties existed between the government, banks, and the private sector (see, among others, Cho and Hellmann, 1993; Choi, 1987; Jones and Sakong, 1980; Lee, 1992; Lee and Naya, 1988; and Wade, 1990). These ties led to frequent contacts between the government and the private sector about the economy's weaknesses and strengths. In this way, the government gained a better understanding of the nature of the coordination problems that played a role in the economy. On the basis of this information the government was better able to take decisions concerning intervention.

In the case of South Korea, civil servants from different ministries, bank managers, and managers of large companies regularly met on so-called *deliberation councils*. Apart from this there were also *monthly export meetings*. At these meetings, presided by the president of the country and attended by senior civil servants, managers of banks and companies, economic bottlenecks were directly discussed, and decisions were taken concerning the outlines of the industrial, trade, and financial policies. Specific attention would be paid to the performance of the export industries, and if necessary the export policy would be adjusted on the basis of the information available.

The South Korean private sector was very much organised on the basis of conglomerate structures, the so-called *Chaebols*. A limited number of very large conglomerates were actively involved in various economic activities, thus controlling an important part of the total production of the private sector. The government actively stimulated the development of these large conglomerates (Woo, 1991). The idea was that this would lead to an optimal use of economies of scale and external effects due to the strong mutual dependence between industries. In this way, the conglomerates would internalise existing coordination problems.

Moreover, an advantage of the existence of several large conglomerates was that there was only a small number of ties between the government and the private sector, so that a relatively small number of policy makers and managers would be responsible for making important decisions (Hermes, 1995). This added to an efficient exchange of information and a reduction of coordination problems.

Some studies describe the model of the East Asian economies as a *governed market*. This means that private companies competed and cooperated and were supervised by the government (Wade, 1990). Other studies - especially referring to the case of South Korea - characterise the relations between government and the private sector as a *quasi internal organisation* (Cho and Hellmann, 1993; Haggard and Lee, 1995; and Lee, 1992), referring to Williamson's internal organisation model (1975). This model describes a firm as an organisation that minimalises transaction costs by internalising certain activities, *i.e.* these activities are executed within the organisation. This may cause the allocation within an internal organisation to be superior to allocation resulting from the market mechanism. The model contains a central management that determines the outlines of the activities of the firm and that delegates the execution and immediate responsibility for the results to different divisions. The divisions are accountable to the central management and have to provide information regularly, enabling the management to change its strategy on the basis of this new information - if necessary. In this way, coordination problems between the different activities can be reduced.

The comparison to the characteristics of the Korean society applies to a certain extent, if the government is regarded as the central manager and the various conglomerates as the divisions. Due to the intense and informal contacts between the government and the private sector, the government had at their disposal information concerning the nature and extent of coordination problems in the economy. On the basis of this information, economic policies could be designed and choices could be made on which industries should be supported, since they were supposed to be of crucial importance to the growth of the country. Furthermore, economic policy programmes could constantly be adjusted on the basis of new information so that they would positively contribute to the economic development of the country.

To conclude, it can be argued that the strong ties between the government and the private sector contributed to an intense exchange of information. Based on this information, the government was able to follow and if necessary adjust the activities in private industries. The new interventionists considered the combination of these ties and the nature of the way the government created rents and distributed these among firms and industrial sectors as an important explanation of the successful government intervention in the various East Asian countries.

4.5 Initial conditions and political factors

The new interventionists also point at other factors they feel have been important in realising that the government translated the information they received from the private sector into a policy that contributed to the successful reduction of coordination problems. These factors are closely related to the initial conditions that applied at the moment this miraculous process of economic growth was started. They also point at certain specific political-economic circumstances.

To begin with, the new interventionists emphasise that in these countries the educational system and the level of education of the labour force were of a relatively high standard as early as the 1950s, especially compared to countries in Latin America and Africa. This positive initial condition had various positive consequences. To start with, this meant that labour productivity was relatively high and that the East Asian economies were at least capable of working with relatively high-grade production processes as early as the 1950s. Moreover, this meant that the copying of Western technologies - which according to Amsden is the essence of late industrialisation - could be executed faster. Finally, the high level of education had a positive effect on the quality of the civil service.

The latter was not to be underestimated as an aspect of the success of the East Asian intervention policy. Several authors have therefore paid special attention to the aspect of the quality of the civil service. An efficient apparatus of government was of great importance in order to translate the information on coordination problems in the economy into a policy that could contribute to increasing economic growth. Moreover, the work ethic of the average civil servant in the Eastern Asian countries was also important in explaining the efficiency of government intervention. In many developing countries civil servants seemed to be easily corrupted, whereas in most East Asian countries this was relatively less common. Consequently, the abuse of, for example, the granting of subsidies and other benefits to firms could be kept rather limited. To explain this phenomenon the new interventionists argued, among other things, that in such countries as South Korea and Taiwan a high degree of social responsibility had been developed and introduced through the educational system. Education very much contributed to a sense of social awareness. This led to the fact that a position as a civil servant involved a high social status. This may be an explanation for the fact that the best students often accepted a position with the government whereas a similar position in the private sector would pay far more. This high status would also contribute to a lower degree of corruptness as compared to that in many other developing countries. Moreover, a career with the civil service was considered the perfect way to a high position in the private sector later (see *e.g.* Wade, 1991; and World Bank, 1993).

Apart from these initial conditions, several authors argue that the political-economic circumstances in the East Asian countries contributed to the fact that government intervention could concentrate on the efficient use of scarce resources. As is well-known from the public-choice literature, a government may implement a policy because they are being pressurised by certain groups in society that are crucial to a possible re-election. In such case, in their policy the government may to a certain extent want to comply with the wishes of their future voters, rather than pursue a policy that contributes to economic growth as much as possible.[9] For example, they may not use subsidies to support certain important economic activities; instead subsidies may be used to secure political support. In many Latin American and African countries such a populist policy has been pursued in the past with all the associated negative consequences to general economic growth. In case of a more autocratic government, the government will use part of the means available to bribe representatives of powerful lobbies who could jeopardise the government's continuity or to forcefully suppress these lobbies.

In South Korea and Taiwan the government hardly ever faced lobbies of real importance so that a populist policy was not necessary. Therefore, they could develop and pursue their policies independent of any lobby and they could efficiently employ subsidies and other instruments to promote economic growth, rather than use them in order to gain political support (see, among others, Haggard, 1990; and Rodrik, 1994). There were several different reasons for this particular circumstance, according to the new interventionists.

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[9] See Schuknecht (1996), among others, for an empirical analysis of such kind of political-economic processes.

To start with, countries like South Korea and Taiwan were characterised by a relatively equal income distribution (Rodrik, 1994) due to which the governments of these countries were less pressurised into taking popular measures to please certain lobbies. The equal income distribution was mainly the result of the land reforms of the 1950s which took place both in South Korea and Taiwan. Thus, equal income distribution had been realised before the start of the period of rapid growth. More recently, empirical support for the positive relation between equal income distribution and economic growth has been found (Alesina and Rodrik, 1994; and Persson and Tabellini, 1994).

Moreover, some mention the fact that both the South Korean and the Taiwanese society were characterised by a relatively cultural unity (Wade, 1991). This meant that this potential source of political instability was less strong than it often was in other developing countries, and that this made it easier to develop a solid nation state. Some authors also mention the fact that the Japanese oppression of South Korea before 1945 drastically reduced the role of lobbies in this country. With respect to Taiwan, the flight of political leaders and their supporters from China had actually decimated the differences between the various political lobbies. Finally, there was no elite based on the ownership of natural resources, since these countries hardly had any natural resources. In several Latin American countries this elite was an important opponent of the government.

4.6 The contributions of the new interventionists: an evaluation

The new interventionists offer an alternative explanation for the economic success of the East Asian countries during the past few decades. They point at the existence of coordination problems and argue that these problems are the main obstacle for economic development. For this reason the government should play an active role. The analysis of the role of the government in East Asia shows under which circumstances government intervention may have a positive impact on the economic growth of a country. The contributions by the new interventionists appear to resemble those by the development economists from the 1940s and 1950s. The difference, however, is that the new interventionists have provided the understandings of the development economists with a more solid theoretical and empirical basis.

Some questions remain unanswered, however. For example, the new interventionist analysis of the role of the government in the East Asian success has not convincingly shown why the efforts of the governments of these countries seemed to have been explicitly concentrated on promoting long-term economic development. This paper has described all conditions that must be met in order for government intervention to contribute positively to economic growth, as was the case in East Asia. However, why do governments in these regions concentrate on maximising social rather than individual welfare? Research into this specific aspect of government intervention and the mechanisms involved appear to be of major importance in determining whether the East Asian model could also be applied elsewhere.

Another starting point for future research refers to the empirical foundation of the existence, nature and importance of coordination problems in a less developed economy. Although the new interventionists have frequently and convincingly described the existence of these failures, until now their empirical proof has been scarcely provided. Therefore, micro-level research - *i.e.* at the industrial level - into the significance of these coordination problems in economic development is vital. Related to this, more empirical research ought to be conducted into the importance of dynamic efficiency in a less developed economy. This requires more analysis of the nature of the possible economies of scale, the external effects in such economies, and the way in which they could be exploited by government intervention.

5. Synthesis of Neoliberalism and New Interventionism?

The debate on the role of the government was quite explicit after the World Bank had published a study in 1993 which contained an in-depth analysis of the backgrounds of the East Asian success. The new interventionists criticised the

World Bank for the contents of this report (see, among others, Amsden, 1994; Kuchiki and Matsui, 1994; Kwon, 1994; Lall, 1994; and Yanagihara, 1994). The analysis in this report builds on an earlier World Bank report (World Bank, 1991) in which the neoliberal view on the role of the government is somewhat changed with respect to their previous attitude on this subject. Both the 1991 and 1993 reports assign a more positive role to government intervention. The reports argue that interventions may add to economic growth, provided that these interventions are market friendly. The market friendly nature of interventions means that markets ought to function freely, unless the results are clearly better in case of government intervention. Furthermore, checks and balances have to be introduced: interventions must always be subject to the discipline of the domestic and foreign markets as much as possible. Finally, intervention must be straightforward and transparent, based on clear regulations, so that the contents and consequences can be monitored by anyone (Singh, 1995, p. 5). The 1991 World Bank report introduces the market friendly approach of government policy as the alternative road between market and government.

Starting from this analysis framework, the 1993 report studies the economic development of East Asia and endorse the positive role of the government in the process of economic development of these countries. Furthermore, the report argues that the distortions that were a result of government interventions were small, especially as compared to those in other developing countries. Government policies were often embedded in a competitive environment, all according to the market friendly approach. At the same time, however, the analysis shows that government intervention was by no means always successful. The market is considered to remain the most efficient coordinating mechanism. Therefore, the report’s advice is to get the prices right. The final conclusion is that the most important positive contributions of government intervention referred to creating a stable macroeconomic environment - in the form of low inflation and government deficits, and a stable exchange rate - and investment in the development of human capital. The government created the right environment within which private initiative could optimally contribute to economic growth. Economic policies should concentrate on these factors, the World Bank argues.

The recent World Bank report does only partly do justice to the new interventionists criticism. The policy recommendations still seem to be rather neoliberal. Although the World Bank report initially appears to lead to a synthesis of the neoliberal model and the new interventionist understandings, the policy implications of the analysis of the two camps differ very much. The new interventionists point at the importance of government intervention and set great store by industrial policies and the use of subsidies and other instruments in order to realise a dynamically efficient allocation of resources, whereas the World Bank continues to argue that the government ought to aim mainly at creating macroeconomic stability and should aim solely at creating the right conditions for private initiative.

To conclude, since the early 1990s there appears to be some general agreement concerning the debate on the role of the government in the process of economic development in East Asian countries. The World Bank - being the main representative of the neoliberal point of view - and its critics agree on the fact that the governments of these countries severely intervened in the economic process. However, there is still great controversy about the effects on and importance of intervention to economic development.

6. Lessons to Other Developing Countries and Eastern Europe?

The discussion described in this article on the economic success of the East Asian countries and the role of the government is highly interesting since it may also provide lessons to other developing countries and the former socialist countries in Easter Europe. The response of the new interventionists to the common neoliberal view concerning the role of the government versus the market has resulted in more explicit attention to a number of important aspects of the process of economic growth.

First, the existence and importance of coordination problems in the economy and the consequent obstacles to economic growth are stressed. This aspect is generally neglected in the neoliberal theory. Second, a better understanding has been gained concerning the issues of how a government can successfully intervene in the processes of allocation and production if coordination problems are significant and of how the government can contribute to a dynamically more efficient distribution of resources.

Third, more knowledge has been obtained concerning the role certain factors play in the process of economic development, such as human capital, income distribution, the capability of the civil service, and the political-economic relations between the government and lobbies in society. It has become clear that in relation to this latter set of factors the East Asian countries were different from most other developing countries and that the economic success of the East Asian model as compared to economic growth in other regions can be at least partly explained by means of these differences. Thus, it is obvious that simply copying the economic model of such countries like South Korea and Taiwan will be problematic if the above mentioned political economic and institutional structures do not exist.[10] These above mentioned characteristics of both countries were important preconditions for effective government intervention.

All of these new insights have shed more light on the process of economic development. These new insights may be of importance when policy recommendations to other developing countries and to the former socialist countries in Eastern Europe are designed. This, however, is not to say that other models will not lead to successful economic growth. In Latin America, for example, a more or less neoliberal policy has recently been rather successful in

[10] Lee (1995) and Singh (1995), however, seem to have more faith in copying at least some of the characteristics of the East Asian model to other countries in order to stimulate their economic development.

Chile and Argentina.

Finally, further research into the questions the new interventionists have not yet been able to answer satisfactorily - as were mentioned see section 4.6 - seems essential before the usefulness of the East Asian models in other regions can be really appreciated.

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